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FOR SETTLEMENT PURPOSES ONLY

VIA E-MAIL

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Re: BP Financial Assurance – Response to EPA Proposed Penalty

Dear Cari and Chrisna:

In preparation for our meeting on November 5th, we want to provide you with BP's counter-proposal to the EPA's demand for penalties as part of the draft Consent Agreement and Final Order ("CAFO"). Although we continue to believe that penalties are not warranted in this matter, BPCNAI is prepared to offer payment of a penalty as part of a full and comprehensive settlement of all issues related to the use of the BPCNAI corporate guarantee for financial assurances.

1. Proposed RCRA Penalty

a. Comments on EPA's Calculations

During our meeting of October 4, 2010, you informed us of EPA's preliminary penalty calculation of approximately \$1.7 million for alleged violations of the financial

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 2

assurance requirements of 40 C.F.R. Parts 264 and 265 (and their state equivalents), based on the factors set forth in the RCRA Civil Penalty Policy. As a threshold matter, we do appreciate that the proposed figure already reflects a number of measures of flexibility, including EPA's acknowledgement that BP did not derive an economic benefit from using the form of guarantee that it did, and that the minimal risk of exposure and effect on the RCRA program warranted a "minor" designation under the "potential for harm" component of the gravity calculation. Nevertheless, we think there are a number of issues that EPA either did not adequately take into account, or should have accounted for differently, in calculating the proposed penalty.

First, as we indicated during the October 4th meeting, we do not believe that the Carson Refinery should be part of the penalty calculation (or, for that matter, the CAFO).¹ The California Department of Toxic Substances Control ("DTSC") issued a summary of violations on May 3, 2010, more than two months before EPA issued its Notices of Violation ("NOVs") for BP's other RCRA facilities.² BP responded to the DTSC notice promptly, providing replacement financial assurances within 30 days – again, well before the EPA NOVs were issued – notwithstanding its disagreement with DTSC's assertion that the existing corporate guarantee was inadequate. The DTSC confirmed in writing on September 7, 2010 that the Company "has addressed the issues identified in the summary of violations." Given that BP fully resolved the compliance matter at Carson with the DTSC prior to EPA involvement, we do not think it is appropriate for EPA to take enforcement action for alleged violations at that facility.

Second, we disagree with EPA's determination that there were 29 violations of the RCRA requirements. EPA's calculation apparently is premised on the theory that the submission of BP's single form of guarantee constituted a violation for *each* financial assurance obligation that it covered (*i.e.*, closure, post-closure, corrective action and sudden and non-sudden liability coverage) at the same facility. We believe that this assessment is not in line with the guidelines set forth in the RCRA Penalty Policy. In particular, we note that Section VII.A.2 of the Policy states: "[t]here are instances where

¹ We understand that EPA counted three alleged violations for the Carson Refinery: (1) post-closure financial assurance; and financial assurance for (2) sudden and (3) non-sudden liability coverage.

² The Carson Refinery was not among the facilities identified in the July 15, 2010 NOVs.

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 3

a company's failure to satisfy one statutory or regulatory requirement either necessarily or generally leads to violations of numbers other independent regulatory requirements." RCRA Penalty Policy at 22-23. The Policy provides that, in such cases, "where multiple violations result from a single initial transgression, assessment of a separate penalty for each distinguishable violation may produce a total penalty which is disproportionately high," and EPA may use its discretion to "compress" the penalties. *Id.* at 23. This is precisely the case here: BP's submission of a single corporate guarantee for each facility encompassing all of the obligations for that facility was a "single initial transgression," and EPA's conclusion that that guarantee did not satisfy the requirements of Parts 264 and 265 "necessarily" led to alleged violations of numerous other requirements of Parts 264 and 265.³ Counting of each of the obligations as a separate violation amounts to the double-, triple- and even quadruple-counting of the same act, resulting in a disproportionately high penalty. The Policy further notes that, in deciding whether to compress penalties, EPA should consider the seriousness of the violation, the importance of the underlying requirement and the economic benefit resulting from each violation. *See id.* Each of these factors weighs in favor of compressing the penalties: EPA necessarily acknowledged in designating the "potential for harm" as "minor" that the potential seriousness of the harm was low, and EPA has agreed that BP derived no economic benefit from not using a different form of guarantee. As to the importance of the requirement, BP has never disputed this, which is why it provided a robust guarantee to support its financial assurances, in good faith belief that the guarantee was compliant. As we noted in our September 8th letter, this is not a situation in which BP misstated its financial strength or failed to have financial assurances at all. Moreover, at the very least, since all of the assurances for third party liability could have been addressed in one instrument, those certainly should be viewed as a single violation. Even allowing for this change in the penalty calculation, the single transgression represented by the non-conforming corporate guarantee would still be multiplied across many sites.

³ Indeed, the facts of this case are closely analogous to the example cited in the Policy as one in which assessment of separate penalties may be disproportionately high: "Examples are the case where . . . a company through ignorance of the law fails to obtain a permit or interim status as required by Section 3005 of RCRA and as a consequence runs afoul of the numerous other (regulatory) requirements imposed on it by 40 C.F.R. Part 265." *See* RCRA Penalty Policy at 22.

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 4

Third, we believe that imposition of multi-day penalties for the alleged violations is not appropriate in this case. The RCRA Penalty Policy is clear as to when such penalties are mandatory or presumptive versus discretionary: “Multi-day penalties are discretionary, generally, for all days of all violations with the following gravity-based designations: *minor-major*, moderate-minor, minor-moderate, minor-minor.” *Id.* at 26. We submit that EPA should exercise the discretion afforded it under the Policy and not seek multi-day penalties for this alleged minor-major violation. Such discretion would be fully warranted here because, unlike a situation in which a violation results in a harm to the environment that continues every day, there was not actual harm in this situation. The potential for harm was essentially nonexistent given the strength of BP’s guarantee,⁴ rendering the “multi-day” aspect of the alleged violation insignificant. Put another way, this was not a case where BP failed to undertake a required activity on a daily basis for an extended period of time. Rather, BP’s single, annual submission for each facility is alleged to have failed to conform to certain requirements.

Fourth, we do not agree with EPA’s selection from the matrix of a dollar figure 25% above the base penalty for a minor-major violation. Rather, we believe that the factors identified in the RCRA Penalty Policy as relevant in assigning a penalty amount militate in favor of a lower figure. For example, one criteria cited in the Policy is the seriousness of the offense “relative to other violations falling within the same cell.” *Id.* at 27. As an example of a violation that EPA would consider having a “major” extent of deviation from the regulations, the Policy cites failure to have a closure plan for a facility. *See id.* at 17. By any measure, that is a more serious violation than the technical non-conformity of the BP guarantee, which was timely submitted and updated annually. Other relevant factors set forth in the Policy include the violator’s “efforts at remediation” and “promptness and degree of cooperation.” *Id.* at 27. In this case, within two weeks of receipt of the NOVs, BP obtained more than \$113 million worth of letters of credit as replacement financial assurance mechanisms in order to address EPA’s (and the states’) concerns regarding the RCRA facilities.⁵

⁴ As we described in our September 8th letter, the Company had in place guarantees from BP Corporation North America Inc., and that corporation’s financial strength exceeded the tests set forth in 40 C.F.R. Part 264 by many orders of magnitude.

⁵ Again, as explained in our September 8th letter, BP had planned on obtaining the letters of credit prior to the NOVs to avoid any possible issues as to its financial assurances, but these efforts were complicated by the uncertainties in the credit markets following the

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Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 5

Fifth, we understand from our October 4th meeting that the EPA's preliminary calculation does not include any downward adjustments to reflect BP's cooperation in the enforcement process, and that EPA has not determined whether and to what extent such an adjustment will be applied. We think it is appropriate for the Agency to reduce the proposed penalty by the full 10% authorized under the Policy. The Company has more than satisfied the criteria applicable to this reduction, from the earliest stages of this matter. For example, BP reached out to EPA within 24 hours of receipt of the NOV's in order to initiate an in-person discussion – including Company representatives – of EPA's concerns, and immediately commenced on a path to obtain replacement instruments. BP also produced to the Agency a substantial number of financial assurance records (in some cases spanning five years or more) to assist EPA in its evaluation of this matter. Finally, BP has remained in regular communication with the Agency throughout the process in order to keep EPA apprised of its progress in providing replacement financial assurances.

Sixth, we believe that BP would be justified in seeking a significant reduction of the penalty based on EPA's prior statements that the form of guarantee provided by BP was acceptable. The RCRA Penalty Policy provides that, where a company "reasonably relies on written statements by the state or EPA that an activity will satisfy RCRA requirements and it is later determined that the activity does not comply with RCRA, a downward adjustment in the penalty may be warranted if the respondent relied on those assurances in good faith." See RCRA Penalty Policy at 36. As detailed in our September 8th letter and in our September 8th document production, EPA Region 8,⁶ as well as the State of Texas,⁷ previously informed BP in writing that the form of guarantee submitted satisfied the regulatory requirements. While we understand EPA's position that, in the case of the Region 8 letters, these statements of compliance came from "the CERCLA side," it is also the case that these statements came from the same agency (EPA) now pursuing enforcement, with regard to financial assurance obligations that explicitly use the RCRA regulations as the appropriate point of reference. See, e.g., Consent Decree for

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creation of the \$20 billion trust fund to address potential liabilities resulting from the Deepwater Horizon incident.

⁶ See January 7, 2010 letters re: Milltown and Butte Mine Flooding Sites.

⁷ See October 6, 2009 letter from TCEQ re: financial assurance for Texas City Refinery.

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 6

the Milltown Site ¶ 65. EPA's determination that the guarantee was compliant is also explicitly stated in the Consent Decree for the Butte Mine Flooding Site. Similarly, while we agree that the 2009 Texas letter included a reservation of rights by TCEQ, the Company was justified in its good faith reliance on that approval.

b. BP's Counterproposal

We believe that it would be reasonable to reduce the proposed RCRA penalty based on each of the six factors described above. However, for purposes of a counterproposal, we are prepared to enter in to a settlement that contains a penalty based on all of EPA's assumptions and inputs except one: the use of the multi-day penalty. In other words, we would accept: (1) the inclusion of Carson; (2) the counting of 29 separate violations; (3) the use of a number above the base numbers from the matrix; and (4) the failure to reduce the penalty based on the statements made by EPA in the CERCLA context. We do think, however, that there should be a 10% discount for the Company's cooperation during this enforcement process. Inputting only these two modifications to EPA's methodology – removal of the multi-day penalty and including the 10% cooperation discount (but using all of EPA's other inputs) – the number is reduced to \$69,426. BPCNAI is prepared to offer that amount to resolve the alleged RCRA violations.⁸

2. SDWA Penalty

a. Comments on EPA's Calculations

Based on our October 20, 2010 teleconference, we understand that EPA has calculated the proposed penalty for alleged SDWA violations based on the following assumptions: (1) that BP's guarantee amounted to a "failure to show evidence of or to maintain financial responsibility," a Level II violation under the SDWA Penalty Policy; (2) that the appropriate gravity multiplier from the Penalty Policy matrix is \$1,000, based on a range of \$401-\$1,000; (3) that the duration of the violation was 58 months; and (4) that 13 underground injection control ("UIC") wells were in violation of the

⁸ This payment would be shared with any state that determined to seek penalties for this issue, and we would ask EPA to help ensure that the settlement comprehensively resolved any State penalty claims as well.

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 7

requirements. As with the RCRA penalty proposal, while we appreciate EPA's acknowledgement of no economic benefit, we believe there are several aspects of EPA's calculation that should be adjusted.

First, in view of EPA's approach in calculating the RCRA penalty, we think the Agency should be consistent and select a gravity multiplier of no more than 25% above the base penalty for a Level II violation, or \$550. Such an adjustment is warranted by the fact that each of the alleged violations stemmed from the same act, *i.e.*, BP's good faith belief that the guarantee provided was valid under the regulations.

Second, we do not think it is appropriate for EPA to base its penalty calculation on a duration of 58 months. Throughout our discussions with EPA on these matters, the focus has been on financial assurances provided over the last seven months, *i.e.*, since BP's March 29, 2010 submission. We note in this context that prior years' financial assurance submissions to Region 10 for the UIC wells in Alaska were explicit as to the form of guarantee provided, and EPA accepted these guarantees without incident until 2010.⁹

Third, we think that the adjustment factors for the gravity component set forth in the SDWA Penalty Policy justify a further reduction of the penalty within the range provided (from minus 30 percent). *See* SDWA Penalty Policy at 11. For example, the Company corrected the violations with respect to the Alaska and Texas UIC wells by obtaining nearly \$19 million worth of letters of credit within two weeks of receipt of the July 15th NOV's, even though the NOV's did not enumerate violations of the SDWA as they did for RCRA. Related, although the UIC wells in Colorado, New Mexico and Wyoming have not been the subject of any NOV, the Company has obtained letters of credit for each of those wells, totaling more than \$4 million.¹⁰

⁹ These submissions (from 2005 to 2010) noted that the obligor on the referenced bond was BP Capital Markets America Inc., a wholly-owned and direct subsidiary of BP Corporation North America Inc.

¹⁰ We understand that EPA is not seeking penalties with respect to these wells.

Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 8

b. BP's Counterproposal

Again, we believe the Company would be justified in seeking reductions based on each of these factors. However, in the interest of resolving this matter, BPCNAI is willing to agree to a penalty settlement based on a gravity multiplier 25% above the base penalty and reflecting a duration of seven months, and accordingly offers a penalty payment of \$12,650 to resolve the alleged SDWA violations.

3. CERCLA Penalty

We understand that EPA has been continuing to discuss internally the proposal outlined in BP's October 13, 2010 letter, *i.e.*, BP will replace the existing guarantees for its financial assurance obligations under certain CERCLA agreements and orders,¹¹ provided that the Agency agrees not to seek a penalty for those obligations. As we noted in our letter, we believe that the Company possesses strong defenses with regard to the adequacy of its existing guarantees under the agreements and orders. Nevertheless, in the spirit of cooperation, BP has signaled its willingness to replace the guarantees with more than \$150 million worth of letters of credit. Given these considerations, we strongly believe that neither stipulated nor statutory penalties are appropriate or recoverable for the CERCLA obligations.

4. Summary of Counterproposal for Resolution of All Financial Assurance Penalties

As we explained during our October 4th meeting, BP does not believe it is appropriate to pursue a "piecemeal" approach to resolution of EPA's financial assurance concerns. We believe that a global settlement is not only the more efficient approach, but also reflects the fact that the alleged violations across *all* regulatory programs stem from a singular regulatory construction by BP with which the Agency finds fault. Accordingly, based on the principles described herein, we propose a penalty payment of \$82,076 by BPCNAI to resolve comprehensively all alleged violations resulting from the use of the BPCNAI guaranty, including the alleged violations cited in the NOV's.

¹¹ These agreements and orders are enumerated in the September 20, 2010 Requests for Information sent to Atlantic Richfield Company and BP Products North America Inc.

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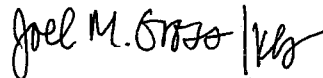
Cari Shiffman, Esq.
Chrisna Tan, Esq.
November 3, 2010
Page 9

We recognize that this proposal is substantially below the Agency's proposal, but we think the Agency's proposal was significantly overstated. Even if a penalty were somehow appropriate here, this was a good faith decision made by BP, in interpreting complex regulations, where EPA itself had signed off on this use of the financial test, and no environmental harm ensued. In other words, our proposal is both: (1) fully consistent with the provisions of the applicable penalty policies; and (2) proportionate to the modest nature of the alleged violations. We hope you will give the proposal the serious consideration that it deserves so that we can move forward with the resolution of this matter.

* * *

We look forward to discussing our counterproposal and other matters with you during our November 5th meeting, and we hope that a fair and prompt resolution of the financial assurance matters can follow.

Sincerely,



Joel M. Gross

cc: Kenneth Patterson, EPA
Christine McCulloch, EPA
Derek Threet, EPA
Manuel Ronquillo, EPA
Robert Genovese, BP
Jean Martin, BP